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IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

CHARLES SCHNABOLK, KALON SYSTEMS, INC.
and ANDRA SYSTEMS, INC.,

Petitioners,

—v.—

SECURITRON MAGNALOCK CORP.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

DAVID JAROSLAWICZ, ESQ.
Counsel of Record
and
ROBERT J. TOLCHIN, ESQ.
JAROSLAWICZ & JAROS
150 William Street
New York, New York 10038
(212) 227-2780
Attorneys for Petitioners

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QUESTIONS PRESENTED

The judgment below presents the following issues for review:

1. Does a single individual who does business through his two closely held corporations sharing a single walk-up office, with one corporation having zero employees and the other havin a historical maximum of 15 employees by, himself constitute an "enterprise" as that term is used in the civil RICO statute?

2. Does the civil RICO statute permit the persons alleged to have committed RICO acts to be exactly the same as the RICO enterprise, with no enterprise existence beyond the particular acts alleged?

3. Does New York's Constitution permit a court to issue an injunction imposing a prior restraint of allegedly defamatory speech?

PARTIES TO THE PROCEEDING

There are no parties to this case other than those appearing in the caption.

Pursuant to Rule 29.1 of the Rules of this Court, appellants state that neither Kalon Systems, Inc. nor Andra Systems, Inc. has any parent corporations, and neither has sold any shares to the public.

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IN THE

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OCTOBER TERM, 1995

NO. _____

SECURITRON MAGNALOCK CORP.,

Plaintiff-Respondent,

-against-

CHARLES SCHNABOLK, KALON SYSTEMS, INC. and ANDRA SYSTEMS, INC.,

Defendants-Petitioners.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

OPINIONS BELOW

This petition seeks review of the opinion issued by the United States Court of Appeals for the Second Circuit on September 7, 1995 (1a*), *Securitron Magnalock* v. *Charles Schnabolk*, 65 F.3d 256 (2nd Cir. 1995), which affirmed the order and judgment of the District Court

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* Page references incorporating the letter 'a' refer to the appendix.

dated October 18, 1994 (24a).

STATEMENT OF JURISDICTION

In seeking review of the decision of the United States Court of Appeals for the Second Circuit, petitioner invokes the certiorari jurisdiction conferred on this Court by 28 U.S.C. § 1254(1).

STATUTES INVOLVED

19 U.S.C. § 1962(c):

It shall be unlawful for any person employed or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of an unlawful debt.

New York State Constitution Article I, Section 8:

Every Citizen may freely speak, write and publish his sentiments on all subjects, being responsible for the abuse of that right; and no law shall be passed to restrain or abridge the liberty of speech or of the press. In all criminal prosecutions or indictments for libels, the truth

may be given in evidence to the jury; and if it shall appear to the jury that the matter charged as libelous is true, and was published with good motives and for justifiable ends, the party shall be acquitted; and the jury shall have the right to determine the law and the fact.

STATEMENT OF CASE

This case stems from a business dispute between two competitors in the magnetic lock business.

The plaintiff-respondent, Securitron Magnalock Corp. ("Securitron") is a major national manufacturer of magnetic locks.

The defendant-petitioner Charles Schnabolk ("Schnabolk") is an engineer who at one time installed Securitron products until he came to the conclusion that there were technical and safety problems with the Securitron magnetic lock and decided to go out on his own to manufacture and install magnetic locks of his own design in the New York metropolitan area. To accomplish this, Schnabolk formed two corporations: the defendant-petitioners Kalon Systems, Inc. ("Kalon") and Andra Systems, Inc. ("Andra"). Both Kalon and Andra were small, closely held corporations operating with zero to minimal managerial staff other than Schnabolk himself, doing business out of a small walk-up office in Manhattan

in New York City.[1]

After the split between Schnabolk and Securitron, Schnabolk, who was a prolific yet clearly untalented letter writer and who was endowed with little tact, proceeded to express his opinion regarding the Securitron lock to whomever would listen. Thus, he wrote rambling letters regarding the Securitron lock to numerous governmental agencies and regulatory authorities, he wrote a letter to the editor in a security trade publication, he wrote to Underwriters Laboratories threatening that if they continued approving the Securitron lock he would expose them as a fraud, he stated to a Newark, New Jersey civil servant that if he awarded Securitron a contract the Schnabolk would get him fired—a threat that the civil servant testified he never took seriously—and he engaged in other similar antics. Schnabolk wrote his letters on different letterheads, including those of Kalon and Andra.

Not to be outdone, Securitron also bad-mouthed Schnabolk's lock. Securitron's president described this as

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[1] The Court of Appeals' decision states that Schnabolk "sold his controlling interest [in Andra] to undisclosed individuals" on May 1, 1989. However, Appellant is not aware of such a sale and there is no basis in the record for this. It would appear that the Court of Appeals based this conclusion on one of the numerous misrepresentations of fact contained in the brief submitted by the respondent, which made numerous factual assertions without specific reference to the record.

the "New York magnetic locks wars."

In the end, Securitron was a much larger and richer company than Schnabolk. In order to gain a commercial advantage and stop Schnabolk from bad-mouthing the Securitron's lock, Securitron hired private investigators and lawyers admittedly to create "fodder" for a lawsuit, and when they had stitched together enough statements by Mr. Schnabolk to form a complaint, in October, 1989 Securitron brought a lawsuit in the United States District Court for the Southern District of New York, alleging civil RICO violations, 18 U.S.C. 1964(c) with predicate acts of mail fraud and wire fraud based on Schnabolk's letter-writing campaign, extortion, obstruction of justice and perjury based on an allegedly false statement made during a civil deposition, conspiracy to commit RICO violations and other claims that the fertile mind of Securitron's counsel, dredged up.

The complaint also contained a New York common law libel claim, and a claim for a purported violation of New York General Business Law § 349, which is a consumer fraud statute and has nothing to do with a commercial dispute. See, *H2O Swimwear, Ltd. v. Lomas*, 164 A.D.2d 804, 560 N.Y.S.2d 19, 21 (1st Dept. 1990).

Before the trial and throughout the trial, defense counsel made repeated motions to dismiss the RICO claims as well as the claims brought pursuant to New

York General Business Law § 349. Each of these motions was denied.

The main argument advanced in support of the application to dismiss the RICO claims was that Securitron had failed to allege or prove the existence of a proper RICO enterprise. The only RICO enterprise ever alleged was Schnabolk, and his two corporations, Kalon and Andra, who are each also alleged to be the RICO persons and who are all nothing but Schnabolk with his different hats or different piles of stationary.

The primary argument advanced in support of the application to dismiss the New York General Business Law § 349 claim was that the damages alleged by Securitron were private to Securitron, and did not impact the public interest in the slightest degree. Indeed, until the Second Circuit decided this case, § 349 had never been held by any court to apply to a private dispute where damages to the public were at best incidental.

The case was tried to a plaintiff's verdict before Magistrate Judge Buchwald (with consent of all parties) and a jury, commencing on July 25, 1994 and ending August 2, 1994. The jury awarded the plaintiff a totally speculative[2] award of $150,000 for lost profits, $100,000

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[2] The only testimony regarding damages was that of Securitron's president who testified that in his "opinion" Securitron

(continued next page)

for out-of-pocket expenses and $100,000 for loss of goodwill, which appears to be duplicative of the lost profits. The trial court then trebled the award pursuant to the RICO statute and without a hearing added over $300,000 in counsel fees and costs. The end result is that Securitron has won the magnetic locks wars and Schnabolk is now basically out of business. The trial court also issued an injunction imposing a prior restraint against Schnabolk making certain statements regarding the Securitron lock.

Clearly, Schnabolk and his unsavory brand of antics impressed neither the trial judge nor the jury. However, even Mr. Schnabolk's disagreeable nature does not suffice to create a RICO claim or a consumer fraud claim out of this ordinary business squabble between two competitors.

This was clearly never a proper RICO case since there was never any RICO enterprise: Charles Schnabolk with his two corporations and two sets of letterhead was never anything more than Charles Schnabolk and his ongoing gripes against Securitron.

In a remarkable departure from its own precedent and the case law of numerous other circuits (see discussion below), the Court of Appeals chose to

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had been damaged by virtue of Schnabolk's bad-mouthing.

overlook the fact that the alleged enterprise was nothing but Schnabolk and his two corporations, one of which had no employees at all. The court's reasoning was merely that:

> these were active, operating businesses rather than two stacks of stationary. Despite Schnabolk's links to each corporation, he, along with his two corporations, clearly is a RICO person as well as a member of a RICO enterprise

(17a). Thus, the Court of Appeals has departed from what has been the law and held that an individual who does business through two closely held corporations can be sued under civil RICO for acts which done in his own name alone could not possibly be RICO. The potential of this decision to permit ordinary disputes to become civil RICO cases is a dangerous and undue extnension of RICO beyond what was ever intended by Congress in enacting RICO.

Similarly, the plaintiff's claims under New York General Business Law § 349 were never tenable. As will be shown below, § 349 is and was intended as a consumer fraud statute, and was never meant to apply to an ordinary business dispute between commercial competitors.

REASONS FOR GRANTING THE WRIT

POINT I

A WRIT OF CERTIORARI SHOULD BE GRANTED SO THAT THIS COURT CAN DECIDE WHETHER AN INDIVIDUAL AND HIS TWO CLOSELY HELD CORPORATIONS, ONE OF WHICH HAD NO EMPLOYEES, CAN BE AN ENTERPRISE FOR CIVIL RICO PURPOSES, WHICH IS AN IMPORTANT QUESTION OF FEDERAL LAW THAT HAS NEVER BEEN DIRECTLY ADDRESSED BY THIS COURT.

The most alarming aspect of the decision reached by the Second Circuit is that the court expanded civil RICO beyond all recognition, for the first time making it possible to bring a civil RICO action dealing with garden variety business disputes and defamation claims against a single individual who does business through two closely held corporations. Thus, the Second Circuit has opened the doors of the federal courts and the threat of RICO treble damages to countless garden variety state law claims which, merely adjusted to fit the mold of a civil RICO claim, can now be brought into federal court.

Petitioner submits that this expansion of civil RICO strains the intent of the statute's drafters, makes the civil RICO statute, which was intended to deal with certain extraordinary types of activity, available for far too many

ordinary business disputes, and exposes defendants to the possibility of awards of treble damages and attorneys fees.

The Second Circuit's decision accomplishes these undesirable results by expanding the realm of what may be considered a civil RICO enterprise.

The enterprise allegation is at the core of any civil RICO case. There can be no RICO case if the defendants are not alleged and proven to have conducted their RICO predicate acts through a RICO enterprise. See, 19 U.S.C. § 1962(c).

However, at least before the Second Circuit's decision, there has always been a requirement that the RICO enterprise be a meaningful entity distinct from the persons alleged to have committed the RICO acts. As Judge Posner explained, "you cannot associate with yourself, any more than you can conspire with yourself, just by giving yourself a non [sic] de guerre." *McCullough v. Suter*, 757 F.2d 142, 144 (7th Cir. 1985). See, *R.R. Brittingham v. Mobil Oil Corp.*, 943 F.2d 297, 301 (3d Cir. 1991) (collecting cases at n. 2).

The alleged RICO enterprise in this case is exactly that: Charles Schnabolk and his two *noms de guerre*, Kalon and Andra, the latter having no employees at all. Since this reflexive tautology is nothing but Schnabolk with two

hats, or piles of stationary, it cannot be a RICO enterprise and the RICO claims should have been dismissed.

To reach the conclusion reached by the Second Circuit, that Schnabolk and his two corporations can together by themselves with no one else involved constitute a civil RICO enterprise, would require that this Court overlook the obvious fact that no corporation can act except through its agents, and that if Schnabolk and his two corporations are an enterprise than any corporation and its employees must be considered an enterprise and thus it would be possible to contort any business dispute involving a corporation into a civil RICO claim.

Even the Second Circuit has recognized that the RICO person and the enterprise must be distinct and that a corporate entity cannot be both a RICO person and a RICO enterprise. *Riverwoods Chappaqua Corporation* v. *Marine Midland Bank, N.A.*, 30 F.3d 339 (2d Cir. 1994). In that case, the Second Circuit wrote that:

> . . . by alleging a RICO enterprise that consists merely or a corporate defendant associated with its own employees or agents carrying on the regular affairs of the defendant, the distinctness requirement may not be circumvented.

Riverwoods, 30 F.3d 339. The *Riverwoods* court went on to state:

> Because a corporation can only function through its employees and agents, any act of the corporation can be viewed as an act of such an enterprise, and the enterprise is in reality no more than the defendant itself.

Riverwoods, 30 F.3d 339.

In our case there was no one involved other than Schnabolk and his two corporations. Thus, there was no enterprise and the RICO claim should have been dismissed and never even submitted to the jury.

Until this case, even the Second Circuit has always held that a corporate enterprise cannot be both the enterprise and the person for RICO purposes. See, *Official Publication* v. *Kable News Co.*, 884 F.2d 664, 668 (2d Cir. 1989); *Bennett* v. *U.S. Trust Co.*, 770 F.2d 308, 315 (2d Cir. 1985), *cert. denied*, 474 U.S. 1058 (1986). That there must be a separate entity distinct from the defendants themselves has always been the law. See, *Alfaro Motors* v. *Ward*, 814 F.2d 883 (2d Cir. 1987).

Attempts to get around the civil RICO requirement of a distinct enterprise by claiming that the enterprise consisted of a corporation and its employees or agents have been rejected by every court which has considered the issue. See, *Board of County Commissioners* v. *Liberty Group*, 965 F.2d 879, 885 (10th Cir.), *cert. denied*, ___ U.S. ___, 113 S.Ct. 329 (1992); *R.R. Brittingham* v. *Mobil Corp.*,

943 F.2d 297, 300-01 (3d Cir. 1991); *Odischelidze* v. *Aetna Life & Casualty Co.*, 853 F.2d 21, 23-24 (1st Cir. 1988); *Entre Computer Centers* v. *FMG of Kansas City*, 819 F.2d 1279, 1287 (4th Cir. 1987); *G.M.Atkinson* v. *Anadarko Bank and Trust Co.*, 808 F.2d 438, 441 (5th Cir. 1987); *Yellow Bus Lines* v. *Teamsters Local 639*, 883 F.2d 132, 139-141 (D.C. Cir. 1989), *cert. denied*, ___ U.S. ___, 111 S.Ct. 2839 (1991) (holding that "an organization cannot join with its own members to do that which it normally does and thereby form an enterprise separate and apart from itself").

The distinct character required to constitute a RICO enterprise was described in *United States* v. *Neapolitan*, 791 F.2d 489, 500 (7th Cir. 1986), where the court quoted from the decision in *United States* v. *Anderson*, 626 F.2d 1358, 1372 (8th Cir. 1980):

> While the hallmark of conspiracy is agreement, the central element of an enterprise is structure. An enterprise must be more than a group of people who get together to commit a "pattern of racketeering activity."
>
> We hold that Congress intended the phrase "a group of individual's [sic] associated in fact although not a legal entity" as used in its definition of the term enterprise in section 1961(4), to

> encompass only an association having an ascertainable structure which exists for the purpose of maintaining operations directed toward an economic goal that has an existence that can be defined a part [sic] from the commission of the predicate acts constituting the "pattern of racketeering activity."

U.S. v. Neapolitan, 791 F.2d at 500.

In a case almost directly in point, *D'Last Corp. v. Ugent*, 863 F.Supp. 763 (N.D. Illinois 1994), an argument was made by one competitor that other competitors and their employees had used illegal and improper tactics. The defendant corporations and their employees were alleged to be the enterprise. In that case, the alleged RICO activities were far more egregious than anything alleged in this case: there were allegations of strong-arm methods, battery, assault, and other such claims. The Illinois District Court held that there was no enterprise and that a business dispute, even under those compelling circumstances, could not be converted into a RICO claim.

Nothing in the record of this case showed that Schnabolk and his two small corporations or any other names he may have used had a structure or criminal enterprise aside from their business of selling and installing security systems. See, *United States v. Turkette*,

452 U.S. 576, 583 (1981).

Put simply, there was no enterprise and there was no RICO case. There was absolutely no showing of any enterprise, no showing of any criminal activity and the RICO claim should have been dismissed.

The decision reached by the Second Circuit in this case would permit any individual who is an officer or employee of a corporation to be sued in federal court for civil RICO anytime upon the commission of three RICO predicate acts. In light of the ubiquitous nature of mail fraud and wire fraud as predicate act allegations in RICO cases, and the fact that almost every business fraud case involves a use of mails or telephones, the decision of the Second Circuit that a corporate officer and his two corporations, one of which had zero employees, can constitute a RICO enterprise promises only to increase the amount of frivolous RICO litigation and the consequent burden on the federal courts. It will also permit persons to be intimidated by RICO suits in situations where RICO was never contemplated to be applicible by Congress or by this Court.

Every other circuit, and indeed even the Second Circuit prior to its decision in this case, has held that the enterprise element of a RICO case is a substantive element which requires more than a single individual and his two closely held corporations.

By granting a writ of certiorari in this case, this Court would be able to closely examine whether the expansion of civil RICO heralded by the Second Circuit's decision is truly within the scope of what was intended by the RICO statute, and to resolve the conflict between the circuits that has resulted from the Second Circuit's decision in this case.

POINT II

A WRIT OF CERTIORARI SHOULD BE GRANTED SO THAT THIS COURT CAN REVIEW THE SECOND CIRCUIT'S DECISION TO SUSTAIN AN INJUNCTION IMPOSING A PRIOR RESTRAINT ON SPEECH, WHICH IS CONTRARY TO ARTICLE I, SECTION 8 OF THE NEW YORK STATE CONSTITUTION.

In addition to awarding money damages, the trial court imposed an injunction against the Schnabolk making certain statements regarding Securitron and Securitron's locks. This injunction, which imposes a prior restraint on speech, is totally contrary to the protections of free speech imposed by the New York Constitution, which surpass the protection afforded by the First Amendment to the United States Constitution.

Remarkably, however, the Second Circuit offhandedly rejected the New York State Constitution's

protections and sustained the injunction, citing no authority and not even engaging in more than a cursory sentence of discussion (21a). A writ of certiorari should be granted so that this glib rejection of the protections afforded by the duly enacted New York State Constitution can be examined by this Court.

The New York State Constitution, Article I, Section 8, specifically provides in relevant part that

> Every citizen may freely speak, write and publish his sentiments on all subjects, being responsible for the abuse of that right...

If an individual abuses that right, the aggrieved party can bring a claim for damages, if it has one and if it can prove any damages. However, under these circumstances there can be no prior restraint on speech.

The cases are clear that in situations of this nature, where a plaintiff is asserting state law claims in federal court, the federal courts should look to the State Constitution and State case law in determining an issue of prior restraint on speech. While the First Amendment to the United States Constitution also applies, when state law is being applied and the state constitution is more protective of free speech, the federal courts should look to the state constitution to determine the case. See, *Kramer* v. *Thompson*, 947 F.2d 666-669 (3d Cir. 1991).

For the Second Circuit to have sustained a broadly based injunction against future statements to be made by the defendants is obviously overbroad, unwarranted and constitutes error.

Similarly, if the plaintiff were to argue that the injunction should be warranted under the libel or slander claim, it could not be upheld because (a) the court's order and judgment is based on § 349 (h) of the General Business Law; and (b) New York law is clear that equity will not restrain a libel which is to occur in the future.

In *Herink v. Harper & Row Publishers, Inc.*, 607 F.Supp. 657 (S.D.N.Y. 1985), Judge Breiant made it clear that "equity will not enjoin a libel," *Id.*, 607 F.Supp. at 660.

Judge Breiant relied upon the classic case of *Brandreth v. Lance*, 8 Paige 24 (N.Y. 1839). The *Brandreth* case has been cited with approval throughout the last 150 years and has been applied to cases where a competitor was accused of maligning a product.

The New York State Court of Appeals in *Marlin Fire Arms Co. v. Shields*, 171 N.Y. 384 (1902), stated in language directly applicable to this case:

> The constitutional guaranty of freedom of speech and press, which in terms provides that 'every citizen may freely speak, write and publish his sentiments on all subjects, being

> responsible for the abuse of that right; and no law shall be passed to restrain or abridge the liberty of speech or of the press' (State Constitution, art I, §8), has for its only limitations the law of slander and libel. . .

and further stated:

> but the precedent which the plaintiff seeks to establish would open the door for a judge sitting in equity to establish a censorship not only over the past and present conduct of a publisher of a magazine or newspaper, but would authorize such judge by decree to lay down a chart for future guidance in so far as a plaintiff's property rights might seem to require, and, in case of the violation of the provisions of such decree, the usual course and practice of equity would necessarily be invoked, which would authorize the court to determine whether such published articles were contrary to the prohibitions of the decree, and, if so found, punishment as for a contempt might follow. Thus a party could be punished for publishing an article which was not libelous and that too without a trial by jury.

Similarly, Justice Cardozo with his customary eloquence spelled out that such a prior restraint would not be proper:

> Courts have enough to do in restraining physical disorder without busying themselves with logomachies in which the embattled words are the expression of the opinion of the writer or the speaker. If there is redress for such a wrong, unassociated with wrongful acts, the remedy is not in equity.

Nann v. Raimist, 255 N.Y. 307, 317, 381 (1931).

Thus, the injunction issued by the trial court, which was grounded in New York Statutory law, General Business Law § 349, clearly violates New York's constitutional free speech protections. This Court should grant a writ of certiorari so that departure from New York's Constitutional law can be addressed.

CONCLUSION

For the reasons set forth herein, this Court should grant the instant petition for a writ of Certiorari, so that the Second Circuit's unwarranted expansions of the civil RICO statute and New York's General Business Law § 349, as well as that court's decision to reject the free speech provisions of the New York State Constitution can be addressed by this Court.

Dated: December 5, 1995

Respectfully submitted,

By: _____

David Jaroslawicz

Counsel of Record

-and-

Robert J. Tolchin, Esq.

JAROSLAWICZ & JAROS, ESQS
150 William Street, 19th floor
New York, New York 10038
(212) 227-2780